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RUEKJCS/JOINT STAFF WASHINGTON DC
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C O N F I D E N T I A L SECTION 01 OF 03 SANAA 001596

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TAGS: ECON EPET EIND ENRG NL YM
SUBJECT: YEMEN'S BLEAK OIL FUTURE: PRODUCTION DECLINE,
LITTLE NEW EXPLORATION ACTIVITY

REF: A. SANAA 1549
¶B. SANAA 227
¶C. SANAA 1375
¶D. SANAA 1121

SANAA 00001596 001.2 OF 003

Classified By: Ambassador Stephen A. Seche for reasons 1.4(b) and (d)

¶1. (C) SUMMARY: Yemen's crude oil production has declined gradually and consistently since peaking in 2001, but it took the past year's drop in oil prices, and the subsequent ROYG budget crisis, to focus the country's economic leadership on problems in the energy sector. A lack of security for new exploration activities, inefficiencies at the national oil company, and a natural decline in the productivity of mature oilfields are all to blame for diminished production. Yemen's economic leadership sees attracting major international oil companies such as BP or Shell as a panacea that would stave off further stagnation and delay the need for politically difficult decisions in the energy and power sectors. This focus on attracting only major companies, none of which have expressed interest in coming to Yemen, serves as a distraction from more feasible goals, such as better maintaining equipment at the national oil company and improving security in the most troubled oil-producing areas (Shabwah, Jawf, and Ma'rib) to facilitate expanded exploration in areas with known reserves. Given other, more pressing threats to the government's stability, energy sector reform will likely have to wait for the next fiscal crisis to come along. END SUMMARY.

OIL WOES: WHAT, OR WHO, TO BLAME?

¶2. (SBU) Yemen's crude oil export revenues have declined sharply over the past year, depriving the country of much needed cash and sparking a new level of soul-searching within the government regarding the lack of new investment in the energy sector. Sharp fluctuations in the global price of oil are more to blame than any dramatic change in Yemeni production levels, which have declined gradually and consistently since peaking in 2001. Yemen's two geological basins, Ma'rib and Masila, suffered production declines of 18% and 30%, respectively, over the past year, according to Ministry of Finance figures, while oil prices dropped by far

greater margins during the same period.

¶3. (C) Some factors driving Yemen's declining production are within the government's ability to reform: a lack of security in oil-producing governorates, corruption within the Ministry of Oil, and insufficient equipment maintenance at Safer, the national oil company. Other factors -- a decline in the efficiency of maturing oilfields and a limited supply of water needed to maintain well pressure -- will remain beyond the ROYG's control. Safer's Block 18, historically Yemen's most productive oil concession block, now produces less than 45,000 barrels per day (BPD), down from 200,000 BPD when U.S. Hunt Oil was the operator throughout the 1990's and early 2000's. "Safer just doesn't do maintenance on its equipment anymore, either out of laziness or lack of funds," Hunt Oil General Manager Mike Graham told EconOff on August 20. Safer General Manager Mohamed al-Hajj faults the natural exhaustion of Yemen's resources, and a lack of new data for continued exploration, for decreased production. ROYG Petroleum Exploration and Production (PEPA) Deputy Chairman Nasr Ali al-Humaidi blames oil companies for not conducting basement drilling that would tap presumed resources held in traps below existing finds. (Note: Oil company contacts are highly skeptical that basement drilling would lead to additional discoveries, given Yemen's known geological features. End Note.)

¶4. (C) With the exception of the Ministry of Oil, which remains ever optimistic about the prospects for a major new discovery, Yemen's economic leadership seems largely to have accepted Yemen's gloomy oil future. "Yemen's future is not in oil, there's none left," Central Bank of Yemen Sub-Governor and oil marketing committee member Ibrahim al-Nahari told EconOff in March. Despite the rollout of a

high-profile "Top 10 Economic Priorities" reform package that mentions Yemen's "promising" oil sector future (REF A), the official behind many of reforms on the list, Deputy Finance Minister Jalal Yaqoub, told EconOff on August 18 that the potential for new oil discoveries was "hopeless, and we know it." Uncharacteristic by usually upbeat ROYG public relations standards, a recent ROYG-sponsored investment promotion advertisement in Foreign Affairs magazine states that Yemeni oil reserves have already peaked and will be depleted by 2020.

FOCUS ON MAJOR OIL COMPANIES AS A PANACEA

¶5. (C) Ministry of Oil officials (REF B) and National Investment Committee members (REF C) view attracting major international oil companies (IOCs) to explore in open blocks as the country's only hope, a strategy that U.S. and local energy analysts uniformly consider a fool's errand. With the exception of French Total, the oil companies operating in Yemen are small- and medium-sized, independent oil companies, most of which do not have access to the capital necessary to properly maintain oilfield services equipment, build expensive pipelines, or exploit advanced technologies that could enhance oil recovery rates. ROYG officials are convinced that attracting even one of a small handful of top IOCs -- companies such as BP, Shell, and ExxonMobil -- would yield dramatically higher production rates at existing wells, significant new discoveries onshore, and big investment in offshore research. According to a 2008 ROYG policy, major oil companies are allowed to negotiate directly with the government rather than compete against smaller firms for concession block tenders. Some ROYG officials seem mystified as to why IOCs have not shown more interest in Yemen's 34 remaining open blocks. "We don't understand. Our PSA (Production-Sharing Agreement) terms are generous, and we're confident the oil is there," Mohamed Thabet, Chairman of the Oil Committee in Parliament, told EconOff. Dismissing the security concerns that have plagued the companies already operating in Yemen, Deputy PEPA Chairman Humaidi said that

major companies will be able to pay the local tribes more money to "keep them quiet" and improve security.

¶6. (C) Major oil companies are unlikely to come to Yemen anytime soon, owing to the rapidly deteriorating security situation and the absence of any compelling geological data hinting at the possibility of major new reserves. Houston-based exploration and production experts from Marathon, ConocoPhillips, and Anadarko all told EconOff in early August that, given current security conditions, their firms are not interested in coming to Yemen. The considerable risks above the ground are simply not balanced out by any signs of something promising below the ground, according to the IOC representatives. Hunt Oil GM Mike Graham, whose company shares Block 5 production with ExxonMobil, says that Exxon long ago ruled out offshore exploration in Yemen: "they did a bit of seismic imagery off the southwest coast and saw nothing persuasive." Shell Oil came to much the same conclusion in 2008, according to internal Shell analyses shared with EconOff by Ministry of Oil consultant Ibrahim Abulohoum (please protect). The Shell report, written by staff geologists after numerous visits to Yemen, states that Block 18 in Ma'rib is the only area with any potential for expanded production and that neither the Yemeni-Omani border region nor any of Yemen's offshore blocks hold much promise. Major IOCs have much higher overhead costs than smaller companies, meaning that much larger discoveries are required to justify exploration and production costs, further adding to the challenges Yemen faces in attracting top firms, according to Graham.

COMMENT

¶7. (C) Neither the ROYG's myopic approach to PSA negotiations with existing companies (REF D) nor its dismissive attitude towards security threats in the field bode wel for Yemen's ability to change the course of it energy future. The

government's single-minded focus on attracting major IOCs, none of which have advanced beyond preliminary talks with the Ministry of Oil, is a distraction from more achievable goals: improving performance at Safer, increasing security in parts of the most troubled oil-producing governorates (Shabwah, Jawf, and Ma'rib), or merely making internal seismological imagery publicly available to potential investors. While the sharp decline in oil revenues has unnerved ROYG economic decision-makers, Ministry of Oil officials see little cause for concern. According to these officials, the next big discovery is always around the corner and decreased production rates portend little more than a temporary setback.

¶8. (C) COMMENT (CONTINUED): From the standpoint of economic reform, the worst thing that could happen to Yemen would be a new oil discovery that would dampen the voices of reformers who argue for a more diversified revenue stream and stave off desperately-needed change in the various ROYG oil agencies. The ROYG's Top 10 Priorities platform, which acknowledges the urgency of oil sector reform, offers the U.S. something with which to hold the government's feet to the fire. Getting the country's leadership to focus on the energy sector at a time when the ROYG is fighting more urgent threats to its stability, however, may be too much to hope for. END COMMENT.
SECHE